IN THE HIGH COURT OF AUSTRALIA
SYDNEY REGISTRY

No S135 of 2016

BETWEEN:

Hua Wang Bank Berhad
Appellant

and

Commissioner of Taxation
Respondent

APPELLANT'S SUBMISSIONS

Part I: Publication

1. This submission is in a form suitable for publication on the internet.

Part II: Issues in appeal

2. When a company is an Australian tax resident it is liable to pay income tax on its entire worldwide income. One of the criteria under which a company becomes an Australian tax resident involves the presence of the company's 'Central Management and Control' in Australia.

3. The question in this appeal is whether the primary judge was obliged to locate the Central Management and Control of the appellant ('HWBB') within HWBB as a juristic entity, or whether it was possible for the Central Management and Control of HWBB to be constituted by a person who 'controlled' HWBB, in the loose sense of human agency, but who had no status as a director or officer of HWBB and at no stage acted *qua* company.

4. The principle contended for by HWBB is that the Central Management and Control of a company must be a part of the company. A controlling individual who cannot be viewed as organic to the company is not the Central Management and Control. This is not a new principle. It has been applied in a large number of cases similar to the present since the 19th Century.

5. Consistent with this view, HWBB submits it is possible for Australian business to establish affiliated corporate entities outside Australia, which for all practical purposes are controlled from Australia, but retain foreign tax residency. If the parent company of a multi-national group has controlling influence over the governing organs of separately constituted offshore entities this does not cause the parent company to become the Central Management and Control of every entity in the group. In point of fact it is normal for Australian businesses to maintain controlled entities in other jurisdictions, and on the correct view of Central Management and Control this form of corporate organization is legally effective.

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6. The primary judge described this form of corporate organization as a *'crooked pantomime'*, an *'elaborate deceit'*, and *'an illusion'*. In the final part of his reasons the primary judge characterized these arrangements as *'tax fraud of the most serious kind'* and said *'the conduct revealed by this case is disgraceful'*. It is apparent that this misconception substantially diverted the primary judge from the task of applying settled principle.

7. The legislature has specifically considered, and rejected, proposals that would prevent Australians from maintaining affiliated, or captive, entities in foreign jurisdictions. For a long time now the Australian tax system has operated on the premise that a controlled foreign entity is not an Australian tax resident. And as outlined at [84] - [88] below, a residency test based on the controlling mind would actively undermine the existing regime for taxing international transactions.

8. For these reasons this court should affirm the test outlined by Dixon J in *North Australian Pastoral v Federal Commissioner of Taxation* (1946) 71 CLR 623 at 628 - 629.

Part III: Section 78B of the Judiciary Act 1903

9. The appellant has considered whether a notice should be given under s 78B and certifies that no notice needs to be given.

Part IV: Decisions in the lower courts

10. The lower court decisions are: *Hua Wang Bank Berhad v Commissioner of Taxation* (2014) 2014 ATC 20-480, and *Bywater Investments Ltd v Commissioner of Taxation* (2016) 329 ALR 385 .

Part V: Narrative Statement

11. HWBB is a private bank incorporated in Samoa. In the first instance proceedings HWBB was challenging its tax liabilities for the income years 2004, 2006 and 2007, which were based on the proceeds from selling shares HWBB held in public companies listed on the Australian Stock Exchange.

12. At all relevant times HWBB had its registered office in Samoa. The company directors worked in Samoa at its only physical place of business. All the other aspects of HWBB's corporate existence were outside Australia. The directors of HWBB were employees of a business called 'Asiaciti Trust'. Asiaciti Trust was a corporate service provider. This means its business was to provide company directors who administer offshore entities in accordance with the wishes of external clients. The effectiveness of corporate service provider arrangements is affected by what is at issue in this appeal.

13. The two principal issues in the first instance proceedings were corporate tax residency and the capital/revenue distinction. The tax liability which HWBB sought to challenge depended on the Respondent's contention that HWBB was an Australian tax resident during 2004, 2006 and 2007, and the shares sold by HWBB were not capital assets but rather revenue assets. The liability in dispute exceeded $7 million, including penalties and interest.

14. It was common ground that if HWBB was not an Australian tax resident and its shares were capital assets, then HWBB was wrongly assessed to tax for 2004,

2006 and 2007. The Australian tax legislation exempts foreign tax residents from tax on capital gains. The exemption is not unqualified, but this appeal does not raise detailed questions about the terms of the exemption.

15. The test for Australian corporate tax residency is posed by the definition of 'resident' in s.6 of the Income Tax Assessment Act 1936. A company is an Australian tax resident if the company has its Central Management and Control in Australia, and the company also does business in Australia. At first instance it was common ground that HWBB did business in Australia. The question in dispute was whether HWBB had its Central Management and Control in Australia.

16. The tax appeal brought by HWBB was heard at the same time as appeals brought by four other companies. The commonality between the five taxpayer companies was that all of them were alleged by the Respondent to be managed by their directors (who without exception were foreigners who lived and worked outside Australia) in accordance with the wishes of an Australian accountant, Mr Vanda Gould. This was said to mean that each of the taxpayer companies had its Central Management and Control in Australia, constituted by Vanda Gould.

17. It was not in dispute that HWBB was at all times a captive entity, run by Asiaciti Trust in accordance with the instructions of Vanda Gould. By contrast the director of three of the other entities, Peter Borgas, gave evidence that Borgas made the substantive decisions and Vanda Gould was purely an advisor to Borgas.

18. The primary judge accepted the directors of HWBB gave truthful evidence. In relation to HWBB specifically:

    (i) Five former directors of HWBB gave evidence in the proceeding. Each was a tax professional of many years' standing.[1]
    (ii) The primary judge found the HWBB directors at all times acted to implement the wishes of Vanda Gould.[2] HWBB had made no submission to the contrary.[3]
    (iii) The primary judge accepted the HWBB directors gave truthful testimony.
    (iv) The primary judge accepted that all the juristic acts of HWBB were performed in Samoa.[4]
    (v) The primary judge said the directors of HWBB would not have knowingly done anything wrong or improper in their capacity as directors.[5]
    (vi) The testimony of the HWBB directors who held office in 2004 - 2007 was that, as directors, each was entirely reactive to communications they received from Vanda Gould. Their practice was to implement Mr Gould's wishes after satisfying themselves these wishes would not compromise the solvency of HWBB[6] and seemed *'within the range of commercial judgment[7]'* .
    (vii) While the primary judge accepted the HWBB directors would not have knowingly done anything improper or unlawful, he said the directors knew

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[1] Transcript 329, lines 30 - 45; Transcript 577, lines 10 - 45; Transcript 880, lines 25 - 30; Affidavit of Graeme Briggs, sworn 19 June 2012, Paragraph [2]; Affidavit of Richard Lead sworn 19 June 2012, Paragraph [1]
[2] Primary judgment at [60] and [417]
[3] Primary judgment at [53]
[4] Primary judgment at [354]
[5] Primary judgment at [364](3)
[6] Transcript 970, 5 - 10
[7] Transcript 349, lines 20 - 45, Transcript 968, 20 - 30; Transcript 586; Transcript 334

so little about the business of HWBB these were *'hollow platitudes'* and an *'empty reservation'*.[8]

(viii) The primary judge accepted that all the indicia of Central Management and Control associated with HWBB were outside Australia,[9] with the exception of an indicium of Central Management and Control described as the 'real business'. The judge said the 'real business' of HWBB was located in Australia because Vanda Gould was in Australia.[10]

19. The written reasons of the primary judge describe HWBB and the other taxpayers as a *'crooked pantomime being conducted on Mr Gould's behalf*[11]*'* and commented *'I find it almost impossible to imagine that these activities* [ie - of HWBB] *could be proper'*.[12] The primary judge concluded the Central Management and Control of HWBB was in Australia, and only Australia. There was no finding that Central Management and Control was split between Australia and Samoa in the case of HWBB, or the other taxpayers.[13] The Central Management and Control test has existed for more than 100 years. The parties to this litigation have not been able to identify any precedent for a company being found to have no part of its Central Management and Control in the jurisdiction where the entirety of its directors, staff, business premises and operations are located.

20. The primary judge indicated it was fraudulent for the directors of HWBB and the other taxpayers to transact business on behalf of these entities when all the commercial decisions were being made by Vanda Gould. In particular the primary judge described the documents the directors of the five companies generated for the purpose of implementing the wishes of Vanda Gould as *'essentially deceitful'*,[14] and suggestive of *'dishonesty'*[15] because they were designed to create the impression that somebody other than Vanda Gould was making the decisions.

21. The primary judge said Vanda Gould must have been the Central Management and Control of HWBB because Vanda Gould was the ultimate owner of HWBB, through a company called JA Investments Ltd in the Cayman Islands (at [352]). The Full Court agreed that HWBB's case depended on the evidence regarding ultimate ownership of JA Investments Ltd (at [16]).

22. The primary judge suggested (at [485]) the taxpayer companies may have engaged in tax fraud, money-laundering and insider trading. Fraud was not an issue in the proceeding. No allegation of money-laundering or insider trading had been particularized by the Respondent or put to the witnesses in the proceeding.

Part VI: Appellant's argument

Overview: the Central Management and Control test

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[8] Primary judgment at [364](3) and [417]
[9] Primary judgment at [416]
[10] Primary judgment at [419]
[11] Primary judgment at [398]
[12] Primary judgment at [351]
[13] Primary judgment at [419]. It is possible for central management and control to subsist in more than one place: *Koitaki v FCT* (1940) 64 CLR 15 at 19, *Swedish Central Railway v Thompson* (1925) AC 495
[14] Primary judgment at [312]
[15] Primary judgment at [415]

23. The concept of Central Management and Control emerged from common law decision-making in the United Kingdom. It was given legislative status in Australia with passage of the Income Tax Assessment Act 1930. The test was re-enacted by the Income Tax Assessment Act 1936 and appears in s.6 of the Income Tax Assessment Act 1936. The provision is as follows:

> ***resident*** *or* ***resident of Australia*** *means: … a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia.*

24. The first articulation of Central Management and Control occurred in *De Beers v Howe* [1906] AC 455. In *De Beers* the House of Lords said a company's tax residence will be where the company has its Central Management and Control, and a company's Central Management and Control will be located where the company's *'real business is carried on'*. This court has affirmed that Central Management and Control is located where a company has its 'real business'.

25. *De Beers* contains little or no discussion of what 'real business' means, and adopted an earlier decision, *Cesena Sulphur*,[16] as correctly stating the law. In that case the court had said: *'a joint stock company resides where its place of incorporation is, where the meetings of the whole company, or those who represent it, are held, and where its governing body meets in bodily presence, and exercises the powers conferred upon it by statute and by the articles of association'*.[17] In *Cesena Sulphur* one of the two taxpayer companies had a purely formal presence in the jurisdiction where it was ultimately held to be resident. The judgment explained that this formal presence constituted the 'real business' or the 'central point' of the company, even though it involved nothing of substance, because under the articles of association the governing body was the source of legal authority for everything that was done by the company.[18]

26. In the early cases the courts' discussion of the 'real business' concept emphasized the importance of identifying the ultimate source of legal authority for activities carried out on behalf of the company by its employees and agents, as distinct from the place of the company's commercial decision-making and activity. This appears from a number of House of Lords decisions.[19] In *North Australian Pastoral* (at CLR 629) Dixon J said the principle that emerges from these decisions is that the 'real business' is located in the place where 'superior directing or controlling authority' is exercised. Dixon J qualified this by saying it is necessary for the authority to be exercised in order to constitute a place of corporate residence. Dixon J said there must be an exercise of authority *'however occasional or however small'* in order for the location of that controlling authority to determine residence (at CLR 631).

27. A number of cases say that Central Management and Control is a multi-factorial test. The indicia of Central Management and Control are accurately set out in [394] of the first instance judgment, and also in *Esquire Nominees* (1973) 129 CLR 177 at 190. It is apparent that many of these indicia of Central Management and

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[16] This judgment relates to two separate matters: *Cesena Sulphur v Nicholson* and *Calcutta Jute v Nicholson*. It is reported as *Cesena Sulphur v Nicholson* (1876) 1 Ex D 428

[17] Ibid at 445

[18] Ibid at 446 - 447 and 456

[19] *San Paulo v Carter* (1896) AC 31 at 39, 41 and 42; *American Thread Company v Joyce* (1913) 6 TC 163 at 164, *New Zealand Shipping v Thew* (1922) 8 TC 208 at 227

Control have nothing to do with how or where decisions are made, and are simply manifestations of a corporation's existence. The legal relevance of these indicia derives from the notion that corporate residency should be evaluated by analogy with a natural person. This court has affirmed the applicability of that analogy.[20]

28. The indicium of Central Management and Control based on where a company is controlled has continued to be treated as highly significant since *Cesena Sulphur* and *De Beers*. This indicium has been described as the 'real business' of the company, although this court described it as the 'superior or directing authority' in both *North Australian Pastoral* (at CLR 629) and also *Koitaki* (at CLR 19 and 22).[21] In this submission the two terms are used interchangeably.

29. This court has considered corporate residency on five occasions.[22] On two of the occasions this court commented, without giving any indication of censure, that the company under consideration had organized its affairs in order to achieve a particular tax residency outcome.[23]

30. The last time this court considered Central Management and Control was *Esquire Nominees*. Since *Esquire Nominees* there have not been any cases in Australia about Central Management and Control, with the exception of a single AAT decision.[24]

31. In Australia the initial response to *Esquire Nominees* was to give consideration to whether Australia should adopt a new test for corporate residency. In1975 the Commonwealth Taxation Review Committee ('the Asprey Committee') investigated whether there should be a new residency test which would cause offshore companies to become Australian residents if their directors *'habitually respond to instructions formulated in Australia'*.[25] This was a reaction to the widely held view that the Central Management and Control test, as expounded in *Esquire Nominees*, can easily be manipulated and effectively allows companies to choose their place of tax residency. Ultimately the Asprey Committee concluded it would be a bad idea to change the test. In 2002 the *Review of International Taxation* acknowledged the Central Management and Control test allows companies to organize their affairs in order to choose their place of residency. The *Review* suggested the test should be changed to make it easier for companies to do this, not harder.[26] No legislative change has been enacted. The test for corporate tax residency continues to be Central Management and Control.

32. The notion of a 'shadow director' does not form part of the jurisprudence concerning Central Management and Control. Nor does the tax legislation adopt

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[20] *Koitaki Para Rubber v FCT* (1941) 64 CLR 241 at 244 and 248, *Koitaki v FCT* (1940) 64 CLR 15 at 19, *North Australian Pastoral v FCT* (1940) 64 CLR 623 at 631

[21] *Koitaki v FCT* (1940) 64 CLR 15 at 19 and 22

[22] *Waterloo Pastoral Company Ltd v Federal Commissioner of Taxation* (1946) 72 CLR 262, *North Australian Pastoral Company Ltd v Federal Commissioner of Taxation* (1946) 71 CLR 623, *Malayan Shipping Company Limited v Federal Commissioner of Taxation* (1946) 71 CLR 156, *Esquire Nominees Limited v Federal Commissioner of Taxation* (1973) 129 CLR 177, *Koitaki Para Rubber v Federal Commissioner of Taxation* (1941) 64 CLR 241

[23] *North Australian Pastoral* at 626, *Esquire Nominees* at 181

[24] This decision was *Crown Insurance Services Ltd v Commissioner of Taxation* [2011] AATA 847 and its approach to Central Management and Control is consistent with the view propounded by HWBB in these submissions.

[25] Asprey Report, Paragraph [17.15]

[26] *Review of International Taxation Arrangements: A consultation paper*, Department of Commonwealth Treasury, 19 September 2002, at 53 - 54

the corporations law concept of 'shadow director'. The role of the shadow director concept in the corporations legislation is to impose liability on natural persons for acts of negligence or wrongdoing. A shadow director cannot perform effective acts for a company where the lawful authority to do so is otherwise lacking.

Submissions: Central Management and Control

33. The primary judge acknowledged that Central Management and Control is a multi-factorial test, and that the formal manifestations of corporate existence are relevant indicia. The primary judge also accepted that all the formal manifestations of HWBB's existence were located outside Australia. With that background, what was decisive in the court's reasoning was the indicium of Central Management and Control based on where a company is controlled, which has been described variously as the company's 'real business' or 'superior or directing authority'.

34. The primary judge and Full Court reasoned as follows:

(a) The primary judge conceived of *'real business'* as something that can only be identified by locating the controlling mind of a company.[27] Both the primary judge and the Full Court considered that this approach is required by a passage from *Koitaki v FCT* (1941) 64 CLR 241 at 248 which says a company's Central Management and Control is located at the place its *'real business'* is carried on, in the sense of *'the place from where its operations are controlled and directed.'* Both courts said (primary judge at [352], Full Court at [16]) a decisive issue was whether Vanda Gould owned JA Investments Ltd, which was the parent company of HWBB and therefore 'controlled' HWBB.

(b) Second, both courts indicated a test based on identification of the company's controlling mind is consistent with *Esquire Nominees v FCT* (1973) 129 CLR 177.

(c) Third, the Full Court (but not the primary judge) cited the decision of the UK Court of Appeal in *Wood v Holden* [2006] EWCA Civ 26 for the proposition that, if company directors merely '[go] *through the motions of passing and signing documents'* the directors will not constitute the 'real business' of the company: Full Court at [9].

(d) Finally the lower courts concluded that, upon application of this test to a company such as HWBB, which was admittedly run by its directors in accordance with the wishes of an Australian resident, Vanda Gould, HWBB did not have its Central Management and Control in Samoa, but solely in Australia.

35. The error of the lower courts was a failure to recognize that the 'real business' or 'superior or directing authority' of a company must be organic to the company, and Vanda Gould was not a part of HWBB. It is correct that identification of the 'real business' requires ascertainment of the place where a company's operations are directed and controlled, but what the inquiry seeks to locate is the place where the organs of the company exercise control, even if that amounts to nothing more than rubber-stamping decisions made elsewhere. The test does not look to the entire universe of possible influences on the company. An outsider who has no legal authority to act *qua* company might be the most influential person in the decision-making of a company in terms of human agency but cannot be treated as

[27] Primary judgment at [352], [364] and [419]

constituting the 'real business' of a juristic entity of which the outsider is not part. The test for residency proceeds by analogy with the human body as stated by *De Beers* and the other authorities. Working within this analogy: an influential outsider who tells company directors what to do is not the part of the corporate body that exercises control over the rest of the corporate body.

36. The primary judge's discussion of the evidence is consummated at [352] and [364] with his conclusion that Vanda Gould 'controlled' HWBB. This was never the question. The question was whether HWBB had its indicia of Central Management and Control in Samoa and, as part of this inquiry, whether the part of HWBB that controlled HWBB was in Samoa.

37. Addressing each of the individual steps in the lower courts' reasoning, outlined above, the errors were as follows:

    (a) The primary judge and Full Court erred by proceeding on an assumption the 'real business' of a company refers to the location of the person who, in the words of the primary judge, is the 'original author' of all the company's decisions.[28] That assumption is contrary to authority of this court which says Central Management and Control is not determined by identifying the person whose individual will guides a company's decision-making.[29] The correct approach to identifying the 'real business' of a company is to ascertain the place where legally effective control is exercised by the corporate organs of governance.[30] In particular, the authorities indicate a company's real business is located where the company directors' meetings occur,[31] except in the extreme circumstance where the board has ceased to function or is bypassed.[32]

    (b) The lower courts adopted an erroneous view of *Esquire Nominees.* The lower courts said *Esquire Nominees* requires company directors to satisfy a qualitative test in order to constitute the Central Management and Control of their company and, in particular, that directors must believe the decisions they take are in the interests of the company. *Esquire Nominees* does not say this.

    (c) The Full Court's reference to *Wood v Holden* reveals a fundamental error about the legal proposition that emerges from *Wood v Holden.* The Full Court said (at [9]) the key point from *Wood v Holden* is that the directors of the relevant company must do more than go through the motions of *'passing and signing documents'* to constitute the 'real business'. This, with respect, is the very proposition the court rejected in *Wood v Holden* (EWCA at [35], [40] and [50]).

    (d) The adoption of an erroneous test caused the lower courts to give determinative weight to matters that, on HWBB's submission, were irrelevant to Central Management and Control. Once the primary judge made a finding the HWBB directors acted *qua* company it was irrelevant that Vanda Gould was

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[28] Primary judgment at [53], [352], [364], [419]
[29] *North Australian Pastoral v FCT* (1946) 71 CLR 623 at 628
[30] *North Australian Pastoral* (Ibid) at CLR 633 - 634, *Koitaki v FCT* (1940) 64 CLR 15 at 21- 22, *John Hood & Co v Magee* (1918) 7 TC 327 at 350 and 357 - 358, *Re Little Olympian* [1995] 1 WLR 560 at 573
[31] *Union Corporation v IRC* (1952) 1 All ER 646 at 657 *Waterloo Pastoral v FCT* (1946) 72 CLR 262 at 267
[32] *Unit Construction v Bullock* [1960] AC 351

the author of all the decisions prior to their adoption by the HWBB directors, and irrelevant that Vanda Gould may have been the ultimate owner of HWBB through JA Investments Ltd. Conversely, the lower courts did not give determinative weight to findings that entitled HWBB to succeed. These were the findings that all the aspects of HWBB's existence were in Samoa, and legally effective exercises of control were performed by the HWBB directors in Samoa.

38. Each of these points is expanded upon hereunder.

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39. **[(a) The real business of a company must be organic to the company]** The primary judge and Full Court did not refer to any of the authorities that explain what the 'real business' of a company is, or how it should be identified. The judgments in the lower courts simply assume that, when this court said in *Koitaki* that the real business of a company is *'the place from where its operations are controlled and directed'* the reference was to the controlling mind of the company, independent of notions of separate legal personality.

40. This assumption is contrary to authority. In *North Australian Pastoral* (1946) 71
20 CLR 623 at 628 Dixon J specifically said corporate residence is not determined by identifying the controlling mind of a company. Dixon J cited the decision in *John Hood v Magee* (1918) 7 TC 327. *John Hood* illustrates that the focal point of the inquiry is the place where actions are performed *qua* company, and in particular the place where actions are performed *qua* constitutional organ of governance.

41. As noted above, in *North Australian Pastoral* Dixon J also said the location of the superior or directing authority determines the place of the real business. By contrast in this proceeding the primary judge said (at [396] - [397]) the superior or directing authority is not relevant to Central Management and Control.

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42. The view that the real business will be at the place where the constitutional organs of a company exercise control was articulated in *Cesena Sulphur*, as outlined above. It was re-iterated in *Union Corporation v IR Comm* (1952) 1 All ER 646 at 657 where the UK Court of Appeal said, referring specifically to *Koitaki v FCT* (1940) 64 CLR 15, that:

> "The company may be properly found to reside in a country where it "really does business", that is to say, where the controlling power and authority which, according to the ordinary constitution of a limited liability company,
40 is vested in its board of directors, and the exercise of that power and authority, is to some substantial degree to be found.'

43. There is an exception to this principle. In *Unit Construction v Bullock* (1960) AC 351 a controlling outsider had completely bypassed appointed company directors and had been acting *qua* company in place of those directors, transmitting instructions directly to company staff and entering transactions. The House of Lords contrasted this case, which Cohen LJ described as exceptional, with a scenario in which a parent company exerts control over its subsidiaries by operating *'through the boards'* of the subsidiary companies (AC at 374).

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44. There are statements in the decision from *Koitaki* about the necessity of identifying the person who controls a company. These statements cannot be divorced from their context. There was no question in *Koitaki* about whether an outsider was the

Central Management and Control. This court was not indicating it was necessary to identify the controlling mind without reference to corporate personality.

45. In the aftermath of *Unit Construction v Bullock* the courts have considered a range of scenarios where a company's organs of governance were functioning as such, but the relevant office-holders simply implemented decisions made elsewhere with minimal consideration, and on the basis of little or no information.

46. [(b) The lower courts adopted an erroneous view of Esquire Nominees]
Esquire Nominees says the place where the corporate organs of governance exert control is the place of the company's 'superior or directing authority', or 'real business', notwithstanding that the organs do nothing more than adopt decisions made elsewhere, and do this on the basis of minimal information. *Esquire Nominees* also says a person cannot be the superior or directing authority unless that person exercises control *qua* company.

47. The analysis of *Esquire Nominees* in the lower courts concentrates on individual observations and comments made by Gibbs J at first instance (at CLR 190 - 191) in a way that tends to obscure the central point. CLR 190 - 191 is not the text of a statute, and Gibbs J did not indicate that any particular one of the factual findings from CLR 190 - 191 (such as his comment the directors of Esquire Nominees Ltd would not have done something they believed was improper) were indispensable to his finding about residency.

48. Also, the parts of the *Esquire Nominees* judgment that the lower courts relied on to distinguish *Esquire Nominees* from the present do not say what was claimed for them by the lower courts. In particular, there was no finding in *Esquire Nominees* the company directors had an independent belief they were acting in the interests of the companies. Gibbs J *did* make a finding that the directors believed they were doing what was best for the beneficiaries of the trusts of which Esquire Nominees Ltd was trustee but that is a different matter. Nor does the rationalization given by the primary judge for the directors' obedience to instructions from Australia (viz: that Esquire Nominees Ltd was a trustee company seeking to build its trustee business) stand up to scrutiny. The court also made a finding that the company Mitchell Credits Ltd was not a resident of Australia. Mitchell Credits Ltd was not a trustee, so the obedience of its directors to Australian controllers is not explicable as a trustee's attempt to build up its trustee business.

49. There is an air of unreality about any suggestion the companies from *Esquire Nominees* operated otherwise than with their directors mechanically adopting the decisions of Australian controllers. However the outcome in the lower courts in this case substantially depended on those courts discerning, somewhere in the *Esquire Nominees* judgments, an indication to the contrary. The primary judge said (at [402]) the view of *Esquire Nominees* propounded in these submissions was *'fanciful'*.

50. In *Esquire Nominees* the courts did not say it expressly, but the conclusion about corporate residency was crucial to the outcome of the case. If Esquire Nominees Ltd had been a resident of Australia rather than Norfolk Island it would have been taxed on its worldwide income, including the dividend received from Mitchell Credits which was the subject matter of the proceeding. This court's conclusion that the dividend received by Esquire Nominees Ltd had its source in Norfolk Island depended on the company which paid the dividend, Mitchell Credits Ltd, being tax resident of Norfolk Island. It was only if this company was resident of

Norfolk Island that the fund of profits out of which the dividend was paid could have been located on Norfolk Island. It is for this reason that all four members of the Full Court made findings about the residency of Mitchell Credits Ltd as well as Esquire Nominees Ltd.

51. [(c) The decision in Wood v Holden] In the first instance proceedings the taxpayers, as well as the Respondent, submitted the test for Central Management and Control is correctly stated in *Wood v Holden* [2006] EWCA Civ 26.

52. It is respectfully submitted the Full Federal Court mis-apprehended, at quite a fundamental level, the ratio from *Wood v Holden*. The Full Federal Court said (at [9]) the ratio of *Wood v Holden* is that directors need to do more than go through the motions of passing and signing documents in order to constitute the real business of a company. This is not what the *Wood v Holden* judgment says. The statement that *'merely going through the motions of passing or making resolutions and signing documents does not suffice'* appears in Paragraph [34] of the Court of Appeal decision in *Wood v Holden*. However Paragraph [34] is a summary of the propositions that the Court of Appeal then went on to say (at [35]) had been properly rejected by the primary judge whose judgment was being appealed to the Court of Appeal. The Full Federal Court's judgment mistakenly avers that the ratio of *Wood v Holden* is a proposition that *Wood v Holden* rejected.

53. What *Wood v Holden* says is the regularly appointed directors of a company, who operate as such, will continue to be its superior or directing authority, notwithstanding that they mechanically adopt the decisions made by a third party: Chadwick LJ at EWCA [43], with Moore-Bick LJ agreeing at [46].

54. *Wood v Holden* said the only circumstances in which a company's regularly established organs of governance will cease to be the indicium of Central Management and Control is: (i) in a scenario of the type considered in *Unit Construction v Bullock*, where an external controller completely bypasses the constitutional organs of governance and purports to act *qua* company, (ii) where the company directors sign documents that are put in front of them without reading them, and (iii) where an external controller transmits instructions to the company directors in the form of a diktat that does not acknowledge any discretion in the directors as to whether or not to implement the instructions.

55. It is accepted this court should adopt the qualification articulated in *Wood v Holden,* based on *Unit Construction v Bullock*. Something discussed below is whether the second two qualifications from *Wood v Holden* (ie - points (ii) and (iii) identified above) represent the law.

56. [(d) the lower courts gave determinative weight to things that were irrelevant] The Full Court said (at [10]) the first instance inquiry was properly directed to whether Vanda Gould was the controlling mind of HWBB, and whether the decision-making of the HWBB directors satisfied the qualitative standard that was said to emerge from the authorities.

57. The Full Court's view about controlling mind appears most conspicuously from Paragraph [16] of the Full Court judgment, where the court said HWBB's case *'depended'* on the evidence given about ownership of JA Investments Ltd, the parent company of HWBB, and whether that evidence was accepted by the primary judge. The same reasoning appears from the primary judgment which said Vanda Gould 'controlled' HWBB.

58. On the correct view of the law these and related matters could not establish that HWBB's Central Management and Control was in Australia, as they were not findings that a part of HWBB (let alone the controlling part) was located in Australia.

59. The primary judge indicated (at [346] and [415]) it was fraudulent for the directors of HWBB to perform transactions on behalf of HWBB because these transactions were designed to create the impression that somebody other than Vanda Gould was making the decisions for HWBB.

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60. The contrary view, put on behalf of HWBB at the first instance hearing, was that it was not dishonest or improper for the directors of HWBB to transact business on behalf of an entity of which they were directors. The juristic acts performed by the HWBB directors (such as the transmission of instructions to stockbrokers about the purchase and sale of shares on the Australian Stock Exchange) contained no warrant about the influences that produced these juristic acts. Also, the performance of these juristic acts by persons situated outside Australia was essential to realizing the evident purpose of the arrangement, which was to lawfully secure foreign tax residency for HWBB. Notably, in the appeal to the Full
20 Federal Court, the Respondent was not prepared to defend all the primary judge's findings that the actions of HWBB and the other taxpayers were fraudulent.[33]

61. The findings by the primary judge that the operation of HWBB was misleading and a façade, even if correct (which they were not), could not bear on the Central Management and Control of HWBB. The fact that an entity presents a misleading front to the outside world does not support any particular conclusion about the internal governance of that entity.

62. Another suggestion by the primary judge was that HWBB had been used as a
30 vehicle for money-laundering (or a *'commercial laundry'* in the primary judge's words[34]) and insider trading. This commentary about money-laundering was based on the misconception that the back-to-back loan arrangements conducted by HWBB, the effectiveness of which has since been upheld by the courts in litigation involving HWBB,[35] were somehow improper. There was no necessity for the primary judge to make these statements. Fraud was not an issue on which anything turned in the first instance proceeding.

63. At first instance the Respondent was required to particularise all the transactions which the Respondent wished to allege were fraudulent. No allegations about
40 money-laundering or insider trading were particularized. There was no suggestion by the Respondent, either in cross-examination or in submissions, that any of the dramatis personae had engaged in insider trading or money-laundering

64. The views of the primary judge, even if correct, were beside the point. A company may be engaged in all manner of illegal activity, but will nevertheless have a Central Management and Control. In particular, a company will have a source of authority for the actions that are performed on its behalf. The place where that authority is situated is its 'real business'.

50 <u>The outcome of applying the correct principle</u>

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[33] Transcript 105, Lines 25 - 45
[34] Primary judgment at [419]
[35] *Fitzroy Services Pty Ltd v Commissioner of Taxation* [2013] FCA 471 at [34] and [54], *Normandy Finance Pty Ltd v Commissioner of Taxation* [2015] FCA 1420 at [142]

65. HWBB makes two submissions on the test for Central Management and Control. On either view, HWBB did not have its Central Management and Control in Australia in 2004, 2006 and 2007.

66. **[Primary submission]** HWBB's primary submission is that the place where a company's regularly appointed directors (or other organ of governance) exercise control constitutes its superior or directing authority, except in the circumstance identified by *Unit Construction v Bullock* where the organ of governance is bypassed by some external person. If there is a contract (or similar device) that gives a third party an enforceable mechanism for controlling the company, its significance will depend on the extent to which the contract allows the third party to exert control *qua* company, and whether the third party exerts this control in fact. Nothing like that arises in the case of HWBB.

67. On this view of the law the factual finding that entitles HWBB to succeed on residency is the finding at [354], that all the business of HWBB was formally transacted by the HWBB directors and staff in Samoa. Related findings were that Vanda Gould's 'control' over HWBB was effected by the transmission of requests and proposals to Samoa where they were implemented by the HWBB directors, and all the manifestations of HWBB's existence were in Samoa.

68. This view of the law does not foreclose the possibility that questions of fact and degree may arise if the manifestations of corporate existence are spread across more than one jurisdiction. The courts have often been required to make evaluative judgements where, for example, a board of directors has conducted some of its meetings in one country, and some of its meetings in a different country; or if executive control is exercised in one place, and strategic control is exercised somewhere else. However these questions of fact and degree are confined to the relative importance of things that are organic to the company.

69. This principle already represents the law and has done so for many years. As a practical matter it is easy to apply. Policy considerations are discussed below.

70. **[Alternative submission]** On HWBB's alternative submission there are several additional criteria, some or all of which may need to be satisfied in order for the regularly appointed directors of a company to constitute the superior or directing authority.

71. The possible criteria are as follows: (i) if the directors are asked to do something they believe is improper or inadvisable they must be disposed to decline (*Esquire Nominees* at CLR 191); (ii) the directors must read documents before signing them; and (iii) instructions transmitted to the directors by an external controller must be expressed as requests rather than orders. If there is an external controller he or she cannot purport to dictate decisions to the directors of the company (per *Wood v Holden*).

72. HWBB satisfied all three criteria if these criteria are applicable, however it is submitted the criteria are not part of the test and are not applicable.

73. **[The directors must decline to do things they regard as improper or inadvisable]**. The primary judge in the present case made findings at [358] and [364](3) the HWBB directors would not have knowingly done anything illegal or in breach of their fiduciary duties. This means the directors satisfied such a test.

74. The primary judge said he would not ascribe substantial weight to the finding the HWBB directors would not do anything improper. He said the directors knew too little about the business of HWBB for this reservation to be meaningful. This should not be accepted. First, *Esquire Nominees* does not say it is incumbent for directors to discharge a duty of inquiry in order for their decisions to constitute the 'real business' of their company. At the highest, what *Esquire Nominees* says is it is necessary for directors to decline to follow unlawful instructions; the primary judge should have followed *Esquire Nominees* rather than impose an additional requirement for a duty of inquiry. Second, *Wood v Holden* says a legally effective act of management does not cease to be an indicium of Central Management and Control because it is taken on inadequate information. Third, a test that causes the place of corporate residency to shift, depending on the moral sense of corporate officers, should not be adopted.

75. HWBB submits it is not an aspect of the test that company directors must decline to perform improper transactions. Gibbs J did not expressly say it was, and it is counter-intuitive in any event. Central Management and Control derives from the location of aspects of the corporate form. It is illogical that a governing organ, such as a board of directors, should no longer be regarded as an aspect of the corporate form simply because its members are prepared to breach their duties. Taken to its logical conclusion this would mean a company whose management engage in illegal activity does not have a Central Management and Control at all. Gibbs J said directors do not cease to manage their own company when they implement the wishes of an external controller. He is unlikely to have thought (and this court should not find) that directors cease to manage their company if they do so in a way that is unethical or amoral. As a practical matter, it is difficult to apply a test to tax periods of twelve months' duration that is based on the state of mind of natural persons, and their hypothetical preparedness to breach their directors' duties.

76. **[The directors must read documents before signing them]** This is not a question about which the primary judge made a finding of fact. The finding recorded in the judgment is the HWBB directors implemented Vanda Gould's instructions in a mechanical fashion.

77. The evidence does considerably more than establish the HWBB directors read documents before signing them. All the directors from 2004, 2006 and 2007 said the documents transmitted by HWBB were prepared in Samoa and they would only implement transactions after satisfying themselves as to the nature of these transactions.[36] The staff of HWBB drafted their own correspondence.[37] They prepared annual financial statements,[38] liaised with the HWBB auditor,[39] and the Samoan corporate regulator.[40] This pattern of activity meets the test, if the test was applicable.

78. HWBB submits no such test is applicable. Central Management and Control treats the corporate form as an analogue of the human body. It is not consistent with this principle for the part of the corporate body that controls the rest, such as the board

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[36] Transcript 970, 5 - 10, Transcript 349, lines 20 - 45, Transcript 968, 20 - 30; Transcript 586; Transcript 334
[37] Inter alia: Exhibits 42, 43, 50, 83, 148, 152
[38] Exhibits: 60, 61, 62, 65
[39] Exhibit 44
[40] Exhibits 58, 73

of directors, to be disregarded because the directors exercise control in a negligent fashion. It makes no sense for the legally effective actions of a diligent company director to be cognisable as an exercise of control while identical (but less informed) actions of a negligent company director, which are fully binding on the company, should not be so regarded. As a practical matter, also, the difficulty of applying this distinction is extreme. At what point is a director's decision to implement the wishes on an outsider no longer a decision?

79. [An external controller cannot dictate to the directors] This is another question on which the primary judge did not make a finding of fact.

80. Communications that passed between Vanda Gould and HWBB were in evidence. Those communications were expressed as requests, not as orders or diktats.[41] The evidence of the HWBB directors indicates they did not regard themselves as taking dictation from Vanda Gould.[42] It was not put to them that they were.

81. The form of words used to outline a course of action to a company director should not bear on Central Management and Control. It is improbable that the way an external person chooses to communicate to a board of directors should affect whether or not they operated as the governing organ of the company. The thing that is important is what the directors do and where they do it; not how an outsider talks to them.

Analysis of the rationale for the principle: Policy issues

84 This court places significant importance on whether a principle has been carefully worked out over a series of cases,[43] and forms part of a stream of authority.[44] The test for Central Management and Control is such a principle. *Esquire Nominees* built on what was said in earlier decisions, going back to *North Australian Pastoral* in this country and cases such as *John Hood* and *Cesena Sulphur* in the United Kingdom. Also *Esquire Nominees* was decided forty years ago. During the intervening years it has formed an assumption that has been the basis for many decisions, both by the legislature and also by private sector actors such as HWBB.

82. There can be no doubt *Esquire Nominees* has generally been taken as authority that Central Management and Control is a formal test, which makes it possible for companies to choose their place of corporate tax residency, and for businesses to establish controlled entities with tax residency in foreign jurisdictions. This is borne out by judicial consideration of *Esquire Nominees*[45] and by academic commentary.[46] It is also borne out by policy discussion, most notably the Asprey Committee's consideration of whether the residency test should be changed to target foreign entities that habitually respond to orders from Australia.

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[41] Exhibit 126
[42] Transcript p.331 - 332, lines 35 - 5; Transcript p.579, lines 5 - 30; Transcript 884, lines 5 - 30
[43] *John v FCT* (1989) 166 CLR 417 at [49]
[44] *Victoria v Commonwealth* (1957) 99 CLR 575 at [45]
[45] *Unigate v McGregor* [1996] STC (SCD) 1 at [46], *Laerstate v Revenue* [2009] UKFTT 209 at [46], *Wood v Holden* [2005] EWHC 547 at [26](ii)
[46] 'Corporate Residence: Has Esquire Nominees stood the test of time?", *Taxation In Australia*, Chan: 1 November 2014; 'When is a company incorporated outside Australia a resident of Australia?', *The Tax Specialist*, June 2015, Burnett at 200; Woellner & Barkoczy, *Australian Taxation Law (16th Edition)*, 2006, at 1382.9

83. There is no clear policy interest served by a residency test based on the controlling mind of a company. It may be conceded a residency test based on notions of substantive control would cause some companies to pay Australian tax when they would not otherwise do so. This does not necessarily mean increased collections for the Revenue. The consequence of a residency test based on controlling mind is that companies with a presence in Australia, which are controlled from overseas, will *not* be Australian residents and will *not* pay Australian tax, even if they have organized their corporate indicia to achieve Australian tax residency. The exclusion of these companies from the tax net would offset gains in collections. Whether or not a permissive residency test would cause an overall net increase in tax collections is a question that cannot be resolved through legal exegesis. It requires empirical evidence and investigation, of the kind that is manifestly the province of tax economists and the legislature rather than the courts.

84. A policy choice has been made by the legislature, and it has been repeatedly affirmed. After *Esquire Nominees* the legislature retained the test for corporate tax residency and enacted several new tax regimes that use Central Management and Control as a test. At the time of writing Central Management and Control is also a criterion for the residency of trusts, superannuation funds, and corporate limited partnerships.[47]

85. The other course taken by the legislature has been to tax the profits of some, but not all, controlled offshore companies on a basis other than tax residency. Commencing in 1990 the legislature introduced no less than four separate regimes for taxing the profits of foreign tax residents if they are controlled from Australia (together, 'the Accruals Regime'). During the income years in dispute in this proceeding (2004, 2006 and 2007) the Accruals Regime from the Income Tax Assessment Act 1936 consisted of hundreds of pages of legislation: Part X ('Controlled Foreign Companies'), former Part XI ('Foreign Investment Funds'), Chapter 6AAA ('Transferor Trusts') and former ss.96A - 96C (the 'deemed present entitlement' rules). The Accruals Regime did then, and does now, operate by attributing the profits of offshore entities to the Australians who control them.

86. The objectives of the Accruals Regime were set out in the Explanatory Memoranda.[48] During the income years in dispute the Accruals Regime operated so that only specific types of profits earned by offshore entities are attributed to their Australia controllers. The Accruals Regime contained a comprehensive set of exclusions for certain types of controlled offshore entity.[49] The Controlled Foreign Companies rules, in particular, purported to tax only the income earned from passive investment vehicles (defined by s.446 as 'passive income') as well as non-arms length income (defined by ss.447 and 448 as 'tainted sales income' and 'tainted services income'). The rules did not then, and do not now, tax the income that offshore entities earn from 'active' economic activity of the sort an Australian business might initiate by setting up a controlled foreign subsidiary for the purpose of selling products and services in a foreign jurisdiction.

87. The decisions given below undermine these design-features of the Accruals Regime. A residency test based on the substance of where a company has its

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[47] Sections 95(2) and 94T, Income Tax Assessment Act 1936; s.295-95(2), Income Tax Assessment Act 1997

[48] Explanatory Memorandum, Income Tax Assessment Amendment (Foreign Investment) Bill 1992, pp.1-8; Explanatory Memorandum, Taxation Laws Amendment (Foreign Income) Bill 1990, pp.1 - 4

[49] Divisions 2 - 14 of former Part XI; ss.102AAF, 102AAH and 102AAZE of Chapter 6AAA; and s.96A of Chapter 6 of Income Tax Assessment Act 1936

controlling mind will cause all controlled entities to become Australian residents; not just passive wealth accumulation vehicles of the sort the legislature has sought to tax under the Accruals Regime. It will cause foreign trading subsidiaries of Australian businesses to become tax residents, including those specifically exempted from the Accruals Regime. At the very minimum it is realistic to expect that, under a permissive residency test, foreign trading subsidiaries will incur large compliance costs to ensure that their place of substantive control is the same as the place of formal control.

88. Any suggestion the Central Management and Control test should be applied more expansively than it has in the past must be reconciled with the policy choice of the legislature to tax the profits of offshore companies selectively, under the Accruals Regime, rather than to indiscriminately treat all offshore companies as Australian tax residents.

89. Even in the absence of considerations arising from the existence of the Accruals Regime and further considerations arising from the proper role of the courts in the development of policy, this court should not overturn *Esquire Nominees* as the Respondent has invited this court to do. Overturning *North Australian Pastoral* would also be a necessity if the reasoning of the lower courts is to be correct, rather than incorrect.

90. The advantage of the test expounded by *Esquire Nominees* and the other cases is that it depends on a precise set of criteria that can easily be understood and applied. It is not difficult to identify where the governing constitutional organ of a company has its meetings, or the location of the other indicia recognized in the authorities. This contrasts with a test that locates the residency of a company in the same jurisdiction as its controlling mind, or declines to treat a functioning organ of governance as the central point of the company if the governing organ does not satisfy a normative test based on qualitative matters such as the personal diligence of the company directors, and their preparedness to act contrary to the interests of the company. These are all matters of degree, and hard to gauge.

91. The vexation that would be caused by adopting and then giving content to a permissive residency test through common law decision-making is illustrated by the decision given in this case by the Full Federal Court. The Full Court indicated that company directors will not constitute the Central Management and Control of a company if they simply '[go] *through the motions of passing and signing documents*', but the Full Court provided no more guidance than this. There was no indication of what threshold needs to be satisfied for nominee directors to be the 'real business' of a company, or for corporate service provider arrangements to be effective.

92. The decisions given below could mean it is impossible for a company to establish tax residency outside Australia if the controlling mind or economic owner of the company is located in Australia. Alternatively the decision could mean that, for a company's 'real business' to be located where its directors meet, it is necessary for the company directors to have a level of commercial input and involvement in substantive decision-making at some unspecified mid-point between dutiful compliance with the wishes of an external controller, and complete independence. These are questions that would need to be answered if this court embraces a test that injects a qualitative element into the notion of 'superior or directing authority'.

93. A related issue is the threshold for an outsider becoming an aspect of the Central Management and Control of a company. The decisions in the lower courts encapsulate two propositions. One, as noted above, is the notion that a functioning organ of governance does not constitute Central Management and Control if the organ does not meet a qualitative standard of decision-making. But the other is the notion that an outsider whose ideas and decisions have no legal status as a part of a company can nevertheless constitute Central Management and Control. The determination by the lower courts was not just that HWBB's organ of governance should be disregarded, but also that Vanda Gould constituted the Central Management and Control of HWBB in an affirmative sense.

94. The proposition that an influential outsider can be the Central Management and Control at the same time as a functioning organ of governance has far-reaching implications. Let it be assumed that the decision-making by the directors of HWBB satisfied whatever qualitative standard the primary judge and the Full Court regarded as necessary for those directors to be an indicium of Central Management and Control. Conceptually, the presence of Central Management and Control in Samoa would not have been a reason for ceasing to treat Vanda Gould as the Central Management and Control in Australia. It is settled law that Central Management and Control can be in more than one place.

95. It is a commercial reality that the head company of a multi-national group has immense influence over its foreign subsidiaries, irrespective of the diligence of the directors of those subsidiaries. Unless this court is prepared to see entire multi-national structures acquire Australian tax residency by reason of their ultimate ownership in Australia (albeit with the offshore entities also having foreign tax residency) it is necessary to identify a principle that differentiates between the levels of non-binding influence that an outsider might have over the decision-making of an offshore company, as well as the sources of influence that can potentially constitute Central Management and Control.

96. These are questions that could give rise to a large amount of litigation. And in the meantime there are thousands of offshore companies, trusts, corporate limited partnerships and superannuation funds that need to know whether their Central Management and Control is located in Australia so that they can accurately return their income for the 2015 - 2016 tax year and make plans in an environment of commercial certainty.

Part VII:

96 The relevant legislative provisions are provided as an annexure.

Part VIII:

97 If HWBB is successful on the question of residency then it is necessary for HWBB to show it held its share portfolio on capital account in order to demonstrate the assessments for 2005, 2006 and 2007 were excessive. The Full Federal Court did not determine HWBB's appeal on the capital/revenue distinction. HWBB therefore seeks to have this issue remitted for determination.

98 The Respondent argues this appeal lacks utility because the Full Federal Court determined the capital/revenue distinction adversely to HWBB and this court has not given special leave in respect of that adverse determination. This is not an accurate characterization of the Full Court judgment. What the Full Court said, in

terms, was *'it would be inappropriate for this Court on appeal to consider whether the primary judge was correct to find that the profits were on revenue account'* (at [18]). This was not a determination of the capital/revenue issue in the Respondent's favour. This was an omission to deal with the issue.

99 The orders sought by HWBB are as follows:

(i) The appeal is allowed.

(ii) Orders 4 and 6 made by the Full Court on 11 December 2015 are set aside.

(iii) Order 1 made by a single judge of the Federal Court on 12 May 2015, regarding the costs of the first instance proceedings, is set aside.

(iv) The finding of the primary judge that the appellant had its central management and control in Australia during 2004, 2006 and 2007 is set aside. The court substitutes a finding that the appellant did not have central management and control in Australia during 2004, 2006 and 2007.

(v) In the alternative to Order 4, the finding of the primary judge that the appellant had its central management and control in Australia during 2004, 2006 and 2007 is set aside, and the matter is remitted to a different judge of the Federal Court for re-trial or alternatively for further hearing of the question of whether the appellant had its central management and control in Australia during 2004, 2006 and 2007.

(vi) The question of whether the appellant held its assets on capital account or on revenue account, and the question identified in [33] of the reasons of the Full Court, are both remitted to the Full Court for determination.

(vii) The respondent pays the appellant's costs of the special leave application and appeal, and also the costs related to the issue of central management and control in the Full Court and at first instance. The remaining costs issues are remitted to the Full Court, or the court of first instance, as the case may be, along with the remaining issues for determination.

(viii) In the alternative to Order (vii), the respondent pays the appellant's costs of the special leave application and appeal, and the remaining costs issues are remitted to the Full Court or the court of first instance, as the case may be, along with the remaining issues for determination.

Part IX:

100 It is estimated the appellant's oral argument will take 3 hours.

Dated: 9 June 2016

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Noel Hutley

John Hyde Page

ANNEXURE - LEGISLATIVE PROVISIONS

Income Tax Assessment Act 1936

6 Interpretation

...

resident or ***resident of Australia*** means:

(a) a person, other than a company, who resides in Australia and includes a person:

(i) whose domicile is in Australia, unless the Commissioner is satisfied that his permanent place of abode is outside Australia;

(ii) who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that his usual place of abode is outside Australia and that he does not intend to take up residence in Australia; or

(iii) who is:

(A) a member of the superannuation scheme established by deed under the *Superannuation Act 1990*; or

(B) an eligible employee for the purposes of the *Superannuation Act 1976*; or

(C) the spouse, or a child under 16, of a person covered by sub-subparagraph (A) or (B); and

(b) a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia.

...

340 Controlled foreign company (CFC)

A company is a CFC at a particular time if, at that time, the company is a resident of a listed country or of an unlisted country and any of the following paragraphs applies:

(a) at that time, there is a group of 5 or fewer Australian 1% entities the aggregate of whose associate-inclusive control interests in the company is not less than 50%;

(b) both of the following subparagraphs apply:

(i) at that time, there is a single Australian entity (in this paragraph called the ***assumed controller***) whose associate-inclusive control interest in the company is not less than 40%;

(ii) at that time, the company is not controlled by a group of entities not being or including the assumed controller or any of its associates;

(c) at that time, the company is controlled by a group of 5 or fewer Australian entities, either alone or together with associates (whether or not any associate is also an Australian entity).

381 Separate attributable income for each attributable taxpayer

Where, at the end of a statutory accounting period (in this Division called the ***eligible period***) of a company:

(a) the company is a CFC; and

(b) there are one or more attributable taxpayers in relation to the company;

the attributable income of the company (in this Division called the ***eligible CFC***) for the eligible period is calculated separately for each such attributable taxpayer (in this Division called the ***eligible taxpayer***) in accordance with this Division.

432 Active income test

(1) Subject to sections 437 and 453, for the purposes of this Part, a company is taken to pass the active income test in relation to a statutory accounting period if, and only if:

(a) the company was in existence at the end of the statutory accounting period; and

(b) there was no time during the statutory accounting period when the company was in existence when the company was neither a resident of a particular listed country nor of a particular unlisted country; and

(c) the company has kept accounts for the statutory accounting period and:

(i) the accounts are prepared in accordance with commercially accepted accounting principles; and

(ii) the accounts give a true and fair view of the financial position of the company; and

(d) the company has complied with the substantiation requirements set out in section 451 in relation to the statutory accounting period; and

(e) at all times during the statutory accounting period when the company was in existence and was a resident of a particular listed country, or of a particular unlisted country, the company carried on business in that country at or through a permanent establishment of the company in that country; and

(f) the tainted income ratio of the company for the statutory accounting period is less than 0.05.

(3) For the purposes of this section, if a company was dormant, within the meaning of Part VI of the *Companies Act 1981*, throughout a particular period (in this subsection called the ***dormant period***) commencing on the day on which the company was incorporated, the company is to be taken not to have been in existence during the dormant period.

433 Tainted income ratio

(1) For the purposes of this Part, if a company is a resident of a particular listed country or a particular unlisted country at the end of a statutory

accounting period, the tainted income ratio of the company for the statutory accounting period is calculated using the formula:

$$\frac{\text{Gross tainted turnover}}{\text{Gross turnover}}$$

where:

Gross tainted turnover means the gross tainted turnover of the company of the statutory accounting period.

Gross turnover means the gross turnover of the company of the statutory accounting period.

(3) For the purposes of this Part, the tainted income ratio of a company for a statutory accounting period is taken to be less than 0.05 if both the numerator and the denominator in the applicable fraction are 0.

(4) For the purposes of this Part, the tainted income ratio of a company for a statutory accounting period is to be calculated in the currency in which the profit and loss accounts and the balance-sheet of the company for the statutory accounting period are prepared.

435 Gross tainted turnover

For the purposes of this Part, the gross tainted turnover of a company of a statutory accounting period is so much of the gross turnover of the company of the statutory accounting period as consists of:

(a) passive income of the company of the statutory accounting period; or

(b) tainted sales income of the company of the statutory accounting period; or

(c) tainted services income of the company of the statutory accounting period.

446 Passive income

(1) Subject to this Division, for the purposes of this Part, the following amounts are passive income of a company of a statutory accounting period:

(a) dividends (within the meaning of section 6) paid to the company in the statutory accounting period;

(b) unit trust dividends (within the meaning of Division 6B or 6C of Part III) paid to the company in the statutory accounting period;

(c) a distribution made to the company where the distribution is taken to be a dividend because of section 47;

(d) tainted interest income derived by the company in the statutory accounting period;

(e) annuities derived by the company in the statutory accounting period;

(f) tainted rental income derived by the company in the statutory accounting period;

(g) tainted royalty income derived by the company in the statutory accounting period;

(h) an amount derived by the company in the statutory accounting period as consideration for the assignment, in whole or in part, of any copyright, patent, design, trade mark or other like property or right;

(j) income derived from carrying on a business of trading in tainted assets;

(k) net gains that accrued to the company in the statutory accounting period in respect of the disposal of tainted assets;

(m) net tainted commodity gains that accrued to the company during the statutory accounting period;

(n) net tainted currency exchange gains that accrued to the company during the statutory accounting period.

(2) Despite anything in subsection (1), the passive income of a life assurance company of a statutory accounting period is calculated using the formula:

$$\text{Adjusted passive income} \times \frac{\text{Total assets} - \text{Untainted policy liabilities}}{\text{Total assets}}$$

where:

adjusted passive income means the amount that, apart from this subsection, would be the passive income of the company of the statutory accounting period.

total assets means the average of the total assets of the company for the statutory accounting period.

untainted policy liabilities means so much of the company's policy liabilities, as defined in the Valuation Standard (within the meaning of the *Income Tax Assessment Act 1997*), as calculated by a Fellow or Accredited Member of the Institute of Actuaries of Australia, for the statutory accounting period as is referable to life assurance policies that do not give rise to tainted services income of the company of any statutory accounting period.

(4) Despite anything in subsection (1), the passive income of a general insurance company of a statutory accounting period is worked out using the formula:

$$\text{Adjusted passive income} \times \frac{\text{Net assets} + \text{Tainted outstanding claims} - \text{Solvency amount}}{\text{Total assets}}$$

where:

adjusted passive income means the amount that, apart from this subsection, would be the passive income of the company of the statutory accounting period.

net assets means the excess at the end of the statutory accounting period of the total assets of the company over the total liabilities of the company.

outstanding claims means the amount that the company would, at the end of the statutory accounting period, based on proper and reasonable estimates, need to set aside and invest in order to meet liabilities of the company that have arisen or will arise:

(a) under general insurance policies (including reinsurance policies, but not including life assurance policies); and

(b) in respect of events that occurred during or before the period.

solvency amount is the amount worked out under subsection (5).

tainted outstanding claims means so much of the outstanding claims of the company at the end of the statutory accounting period as is referable to general insurance policies that give rise to tainted services income of the company of any statutory accounting period.

total assets means the total assets of the company at the end of the statutory accounting period.

(5) In subsection (4):

solvency amount is the amount worked out using the formula:

$$\left[\text{Minimum solvency} + \text{Maximum event retention}\right] \times \left[1 - \frac{\text{Tainted outstanding claims}}{\text{Outstanding claims}}\right]$$

where:

maximum event retention means the amount that, at the end of the statutory accounting period, the company has determined is the maximum that would be payable to the owners of policies as a result of the happening of any one event. The amount must be worked out on the basis of a reasonable and proper estimate.

minimum solvency means the greater of:

(a) 20% of the company's premium income (within the meaning of the *Insurance Act 1973*) during the statutory accounting period; and

(b) 15% of the company's outstanding claims as at the end of the statutory accounting period.

outstanding claims means the amount that the company would, at the end of the statutory accounting period, based on proper and reasonable estimates, need to set aside and invest in order to meet liabilities of the company that have arisen or will arise:

(a) under general insurance policies (including reinsurance policies, but not including life assurance policies); and

(b) in respect of events that occurred during or before the period.

tainted outstanding claims means so much of the outstanding claims of the company at the end of the statutory accounting period as is referable to general insurance policies that give rise to tainted services income of the company of any statutory accounting period.

447 Tainted sales income

(1) Subject to this Division, for the purposes of this Part, the following amounts are tainted sales income of a company of a statutory accounting period:

(a) income from the sale of goods by the company where all of the following conditions are satisfied:

(i) the goods were sold to the company by another entity;

(ii) either of the following sub-subparagraphs applies at the time of the sale of the goods to the company:

(A) the seller of the goods to the company was an associate of the company and a Part X Australian resident;

(B) the goods were sold to the company by an associate of the company who was not a Part X Australian resident, in the course of a business carried on by the associate at or through a permanent establishment of the associate in Australia;

(iii) if the goods were altered by the company—the income does not pass the substantial alteration test set out in subsection (4);

(b) income from the sale of goods by the company where all of the following conditions are satisfied:

(i) the goods were sold to the company by another entity;

(ii) either of the following sub-subparagraphs applies at the time of the purchase of the goods from the company:

(A) the purchaser of the goods from the company was an associate of the company and a Part X Australian resident;

(B) the purchaser of the goods from the company was an associate of the company who was not a Part X Australian resident and the purchase was made in the course of a business carried on by the purchaser at or through a permanent establishment of the purchaser in Australia;

(iii) if the goods were altered by the company—the income does not pass the substantial alteration test set out in subsection (4);

(c) income from the sale of goods (in this paragraph called the ***manufactured goods***) by the company where all of the following conditions are satisfied:

(i) the manufactured goods were manufactured by the company;

(ii) any of the raw materials or goods from which the manufactured goods were manufactured were sold to the company by another entity;

(iii) either of the following sub-subparagraphs applies at the time of the sale to the company of the raw materials or goods from which the manufactured goods were manufactured:

(A) the entity who sold to the company the raw materials or goods from which the manufactured goods were manufactured was an associate of the company and a Part X Australian resident;

(B) the raw materials or goods from which the manufactured goods were manufactured were sold to the company by an associate of the company who was not a Part X Australian resident, in the course of a business carried on by the associate at or through a permanent establishment of the associate in Australia;

(iv) the income does not pass the substantial manufacture test set out in subsection (4A);

(d) income from the sale of goods (in this paragraph called the ***manufactured goods***) by the company where all of the following conditions are satisfied:

(i) the manufactured goods were manufactured by the company;

(ii) any of the raw materials or goods from which the manufactured goods were manufactured were sold to the company by another entity;

(iii) either of the following sub-subparagraphs applies at the time of the purchase of the manufactured goods from the company:

(A) the purchaser of the manufactured goods from the company was an associate of the company and a Part X Australian resident;

(B) the purchaser of the manufactured goods from the company was an associate of the company who was not a Part X Australian resident and the purchase was made in the course of a business carried on by the purchaser at or through a permanent establishment of the purchaser in Australia;

(iv) the income does not pass the substantial manufacture test set out in subsection (4A);

(e) income from the sale of goods (in this paragraph called the ***primary production goods***) by the company where all of the following conditions are satisfied:

(i) the primary production goods were:

(A) primary products produced, raised or grown by the company; or

(B) goods manufactured by the company, in whole or in part, from primary products produced, raised or grown by the company;

(ii) any of the propagative material from which the primary products were produced, raised or grown was sold to the company by another entity;

(iii) either of the following sub-subparagraphs applies at the time of the sale to the company of the propagative material:

(A) the entity who sold the propagative material to the company was an associate of the company and a Part X Australian resident;

(B) the propagative material was sold to the company by an associate of the company who was not a Part X Australian resident, in the course of a business carried on by the associate at or through a permanent establishment of the associate in Australia;

(iv) the income does not pass the substantial production test set out in subsection (4B);

(f) income from the sale of goods (in this paragraph called the ***primary production goods***) by the company where all of the following conditions are satisfied:

(i) the primary production goods were:

(A) primary products produced, raised or grown by the company; or

(B) goods manufactured by the company, in whole or in part, from primary products produced, raised or grown by the company;

(ii) any of the propagative material from which the primary products were produced, raised or grown was sold to the company by another entity;

(iii) either of the following sub-subparagraphs applies at the time of the purchase of the primary production goods from the company:

(A) the purchaser of the primary production goods from the company was an associate of the company and a Part X Australian resident;

(B) the purchaser of the primary production goods from the company was an associate of the company who was not a Part X Australian resident and the purchase was made in the course of a business carried on by the purchaser at or through a permanent establishment of the purchaser in Australia;

(iv) the income does not pass the substantial production test set out in subsection (4B).

(2) Where:

(a) a company provides any of the following services:

(i) drinks and meals;

(ii) accommodation in a hotel, motel, guest-house or similar place;

(iii) the provision of, or the use of facilities for, entertainment, recreation or instruction; and

(b) if subparagraph (a)(ii) or (iii) applies—the transaction for the provision of the services includes the sale of goods of a kind that are commonly supplied in connection with the services concerned;

the tainted sales income of the company does not include income from the sale of:

(c) if subparagraph (a)(i) applies—the drink or food concerned; or

(d) if subparagraph (a)(ii) or (iii) applies—the goods referred to in paragraph (b).

(3) The tainted sales income of a company of a statutory accounting period does not include passive income of the company of the statutory accounting period.

(4) For the purposes of this section, income from the sale of goods by a company passes the substantial alteration test if:

(a) the company substantially altered the goods; and

(b) a substantial part of that alteration was carried out by the directors or employees of the company.

(4A) For the purposes of this section, income from the sale of goods by a company passes the substantial manufacture test if a substantial part of the manufacture of the goods was carried out by the directors or employees of the company.

(4B) For the purposes of this section, income from the sale of goods by a company passes the substantial production test if:

(a) if the goods are primary products—a substantial part of the production, raising or growing of the goods was carried out by the directors or employees of the company; or

(b) if the goods are manufactured by the company, in whole or in part, from primary products produced, raised or grown by the company—a substantial part of:

(i) the manufacture of the goods; and

(ii) those production, raising or growing activities;

was carried out by the directors or employees of the company.

(4C) For the purposes of subsections (4), (4A) and (4B), the effect of an activity on the market value of the goods concerned is to be ignored.

(5) If, apart from this subsection, goods are purchased or sold by 2 or more entities acting jointly, subsection (1) is to be applied successively as if each such entity were the sole purchaser or seller, as the case may be.

(6) In this section:

animals includes fish.

primary products means:

(a) agricultural or horticultural produce; or

(b) trees or crops, whether on or attached to land or not; or

(c) timber; or

(d) animals (whether dead or alive); or

(e) the bodily produce (including natural increase) of animals.

448 Tainted services income

(1) Subject to this Division, for the purposes of this Part, the following amounts are tainted services income of a company of a statutory accounting period:

(a) income (other than premium income) from the provision of services by the company to an entity, if:

(i) the entity was a Part X Australian resident at the time the income was derived; and

(ii) the services were not provided in connection with a business carried on by the entity at that time at or through a permanent establishment of the entity in a listed or unlisted country;

(b) income (other than premium income) from the provision of services by the company to an entity who was not a Part X Australian resident at the time the income was derived, in connection with a business carried on by the entity at that time at or through a permanent establishment of the entity in Australia;

(c) income consisting of life assurance premiums in respect of a life assurance policy if, at the time the policy was entered into, the owner of the policy was a Part X Australian resident;

(d) income consisting of premiums (other than life assurance premiums) in respect of insurance (other than reinsurance) where any of the

following conditions are satisfied at the time the policy was entered into:

(i) any insured person was a Part X Australian resident, and the policy was not entered into in connection with a business carried on by the person at or through a permanent establishment of the person in a listed or unlisted country;

(ii) any insured property was situated in Australia;

(iii) any insured event was an event which could happen only in Australia;

(e) income consisting of premiums in respect of reinsurance, if:

(i) the insurer whose risks are directly covered by the reinsurance was a Part X Australian resident at the time the policy was entered into; and

(ii) the policy was not entered into in connection with a business carried on by the insurer at that time at or through a permanent establishment of the insurer in a listed or unlisted country;

(f) income consisting of premiums in respect of reinsurance, if:

(i) the insurer whose risks are directly covered by the reinsurance was not a Part X Australian resident at the time the policy was entered into; and

(ii) the policy was entered into in connection with a business carried on by the insurer at that time at or through a permanent establishment of the insurer in Australia;

(g) income of the company covered by subsection (1A).

(1A) Income of the company is covered by this subsection if:

(a) it is income from the provision of services by the company to an entity under a scheme (within the meaning of the *Income Tax Assessment Act 1997*); and

(b) the entity is an associate of the company; and

(c) those services are received by another entity; and

(d) the other entity satisfies either of these requirements:

(i) the other entity was a Part X Australian resident at the time the income was derived, and the services were not received in connection with a business carried on by the other entity at that time at or through a permanent establishment of the other entity in a listed or unlisted country;

(ii) the other entity was not a Part X Australian resident at the time the income was derived, and the services were received in connection with a business carried on by the other entity at that time at or through a permanent establishment of the other entity in Australia; and

(e) the income would be tainted services income if:

(i) this section did not include paragraph (1)(g) or this subsection; and

(ii) the income were from the provision of those services by the company to the other entity; and

(f) a reasonable person would conclude (having regard to all the circumstances) that the scheme was entered into or carried out for a

purpose, other than an incidental purpose, of enabling entities satisfying the requirements of subparagraph (d)(i) or (ii) to receive those services.

(2) The tainted services income of a company of a statutory accounting period does not include income from the sale of goods by the company.

(3) Where:

(a) a company provides services directly related to goods sold by the company; and

(b) either of the following conditions is satisfied:

(i) the company substantially altered the goods with the result that the market value of the goods was substantially enhanced;

(ii) the company did not acquire the goods from another entity;

the tainted services income of the company does not include income from the provision of those services.

(4) Where a company provides any of the following services:

(a) drinks and meals;

(b) accommodation in a hotel, motel, guest-house or similar place;

(c) the provision of, or of the use of facilities for, entertainment, recreation or instruction;

the tainted services income of the company does not include income from the provision of those services.

(5) The tainted services income of a company of a statutory accounting period does not include the passive income of the company of the statutory accounting period.

(6) The tainted services income of a company of a statutory accounting period does not include income where:

(a) the income is not passive income of the company of the statutory accounting period; and

(b) the income is covered by any of the following subparagraphs:

(i) income derived by the company by way of rent in respect of a lease of land;

(ii) royalties derived by the company;

(iii) income derived from carrying on a business of trading in assets;

(iv) gains that accrued to the company in the statutory accounting period in respect of the disposal of assets;

(v) gains that accrued to the company in the statutory accounting period from disposing of commodity investments;

(vi) currency exchange gains that accrued to the company in the statutory accounting period;

(vii) in the case of a life assurance company—an amount that, apart from subsection 446(2), would be passive income of the company of the statutory accounting period;

(viii) in the case of a general insurance company—the amount that, apart from subsection 446(4), would be passive income of the company of the statutory accounting period.

(7) If, apart from this subsection, services are provided to 2 or more entities acting jointly, this section is to be applied successively as if each such entity were the sole recipient.